In the Supreme Court
OF THE
United States

OCTOBER TERM, 1940

No.

GILBERT MOODY, JAMES H. JORDAN and WALTER J. SELBY,
Petitioners,

vs.

JAMES IRRIGATION DISTRICT, Debtor,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. FACTUAL BACKGROUND OF THE CASE.

Some of the facts are stated under the heading Summary Statement of the Matter Involved, in the accompanying petition. There is also a statement of some of the facts in the opinion of the court below. (*In re James Irr. District,* 25 Fed. Sup. 974.) This case was heard in the Circuit Court of Appeals upon an agreed statement of the case. (R. 2.)

The James Irrigation District was organized February 6, 1920, under the California Irrigation District

Act, and contained an area of 24,390 acres situate in Fresno County, California. In 1920 it issued a million dollars in bonds in the denomination of $1000, of which $995,000 are involved in these proceedings, together with $21,954.75 of warrants. A considerable amount had matured. The District also overlapped Reclamation District 1606 which is likewise a public corporation, organized under the provisions of the Political Code of California. The plan of composition offers 24.976¢ on each dollar principal, with nothing for interest, and provides further that bondholders accepting the plan must turn in with their own bonds a proportionate amount of the bonds of the Reclamation District. The Reclamation District had outstanding $445,000 in bonds secured by an assessment on the lands within that district. These two districts largely overlap. Where an irrigation district bondholder did not have a bond to turn in, he was required to pay to the irrigation district a certain sum in cash with which to acquire a proportionate amount of reclamation bonds he did not own, so that the net amount offered to the irrigation district bondholder in the composition plan was $188.80 per thousand dollar bond.

The bankruptcy petition was filed December 7, 1937. It was shown that on October 30, 1937, the James Land Corporation owned bonds of the irrigation district in the total principal amount of $944,000, and all of the outstanding warrants except $28.36, and that A. L. Cowell owned bonds of the district in the amount of $21,000. These bonds and warrants were turned in in acceptance of the plan.

The only non-consenting and objecting creditors were the petitioners who own $19,000 of the principal amount of bonds. In their answer they claim this amount with interest represented by the coupons and also with interest as provided by Section 52 of the California Irrigation District Act. These objecting creditors filed claims in which they set forth the dates of maturities and dates of presentation of their claims to the treasurer of the district. Section 52 of the California Irrigation District Act provides:

> "Upon presentation of any matured bond of the district, the treasurer shall pay the same from the bond principal fund, and upon presentation of any matured interest coupon of any bond of the district, the treasurer shall pay the same from the bond interest fund. If money is not available in the fund designated for the payment of any such matured bond or interest coupon, it shall draw interest at the rate of seven per cent per annum from the date of its presentation for payment until notice is given that funds are available for its payment, and it shall be stamped and provision made for its payment as in the case of a warrant for the payment of which funds are not available on its presentation."
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> Cal. Stats. 1931, p. 172 as amended.

It is contended by the petitioners that this act as construed by the California courts creates a "preference by law" in favor of the matured claims which have been so presented and registered. The answers and claims of the petitioners showed that the total amount of $11,770 of then matured bonds and coupons had been presented to the treasurer of the district for

payment and registered pursuant to this act. (R. 14-17.)

Subsequent to the filing of the bankruptcy petition the consenting creditors transferred their interests to the R.F.C. and that corporation filed a claim, but none of the matured claims had ever been presented to the treasurer for payment at least since the year 1929. The treasurer could not say of his knowledge what occurred before then but evidently they never had been presented, since the R.F.C. did not in its verified claim make any claim that any of the matured bonds had ever been presented to the treasurer or had ever been registered (R. 18) and the district's records disclosed no such presentation. (Findings, R. 84.) This, although $545,000 of bonds and $510,000 of coupons had matured and were unpaid at the time of the hearing. (R. 70.)

All of the land within the district except approximately 120 acres is owned by the district. (R. 19.) The same land had been sold to the state for delinquent taxes but on December 27, 1937, the district purchased the state's title for $54,000 which was about 17¢ on the dollar of delinquent taxes. (R. 19.) The district quieted title to the land (R. 19) and of course has acquired the interest of the Reclamation District through the composition plan, and the payments made to it out of the moneys received from the James Land Corporation and A. L. Cowell, so that the title to the property is free and clear in the district except the 120 acres referred to.

The district has assessed the value of its land for taxation purposes at $967,450 (R. 19) and entered into contracts to sell most of its land but the payments have not been completed and under California law these sales are subject to the bonded indebtedness.

Provident Land Corporation v. Zumwalt, 12 Cal. (2d) 365.

The district applied to the R.F.C. for a loan in 1935 under provisions of Section 36 of the Emergency Farm Mortgage Act, being Title 43, Section 403, U.S.C. The loan provided that refunding bonds should be issued in the amount of $256,500 to be sold to the corporation. The contract with the R.F.C. provided that no disbursement would be made until at least 90 per cent of the securities had been deposited and provided for a scale of payment to the bondholders depending upon the amount of bonds deposited. (R. 20, 22.) The contract also provided that no disbursement would be made by the R.F.C. until the borrower (that is the district) had complied with the general conditions set forth. It also provided certain special conditions, one of which was that substantially all of the land should be placed in private ownership, another that the bonded indebtedness of the Reclamation District should be cancelled, the property relieved of delinquent taxes, and no contracts of the land sales made without approval of the R.F.C. (R. 23-24.)

Petitioner's claims amounted to $29,830 principal and coupons, plus interest as provided in Sec. 52. (Findings, R. 82-84.)

The R.F.C., before it made its disbursements, required that the district should deposit $30,000 (R. 40), an item called "Extended Credits". This was interpreted by the court and by counsel for the district as a "guarantee" that there would be funds to pay the outstanding undeposited bonds. (R. 54.) This procedure for the liquidation of the James Land Corporation (and Cowell's) interests and the deposit of the "guarantee", carried out without any court authorization would seem to consummate the plan extrajudicially.

An election was held by the people living in the district (R. 42) at which the proposition voted upon was whether the district should enter into the contract with the R.F.C. to issue refunding bonds in the amount of $256,500 for the purpose of reducing the indebtedness of the district (R. 43), pursuant to the provisions of California Statutes 1917, page 243, as amended, of which Section 3 provides:

> "Any proposal to enter into a contract with the United States for the repayment of construction moneys, the cost of a water supply or the acquisition of property, and to issue bonds, if any be proposed, shall be voted upon at an election wherein proceedings shall be had in so far as applicable in the manner provided in the case of the ordinary issuance of district bonds."

The California Districts Securities Commission, having authority over the financial affairs of this district in the matter of the issuance of bonds under the provisions of California Statutes 1917, page 243, as amended, and California Statutes 1931, page 2263, as

amended, made an order approving the issuance of the bonds. (R. 44.) This commission, also, on September 17, 1937, made an order validating the refunding bonds (R. 47) as provided by the California Districts Securities Commission Act (Cal. Stats. 1931, p. 2263, as amended) in which this commission determined (R. 49):

> "That the reasonable value of the water, water rights, canals, reservoirs, reservoir sites, irrigation works and other property owned by the district is estimated in excess of the sum of $1,000,000; that the reasonable value of the lands within the boundaries of said district is estimated to be in excess of $960,000;
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> "That the $256,500 par value of refunding bonds under consideration, including bonds authorized but not sold, does not exceed sixty (60) per centum of the aggregate value of the water, water rights, canals, reservoirs, reservoir sites, irrigation works and other property owned by the district, and the reasonable value of the lands within the boundaries of the district."

This report and finding was signed by the commission including H. E. Vogel who was a principal witness for the district at their bankruptcy hearing and his testimony is referred to by the court below as substantiating the bankruptcy plan. In spite of Vogel's concurrence in the above finding, yet he testified that "he thought that the indebtedness of $256,500 provided in the plan of composition was well up to the limit of the ability of the lands in the District to meet". (R. 64.) On the same page of the record appeared his statement that if the value of the land

was to be determined from the annual income it would be practically nil, but as a speculative value it would be only a guess. Annual income is not the sole evidence of value, and ability to pay is not the gauge of the state's power of taxation.

The evidence showed that the R.F.C. was paid interest at 4% on the amounts disbursed from and after December 28, 1937, the date of disbursement.

The district's financial statement showed $68,886.56 on hand (Court's Findings, R. 85), of which $12,597.30 is in bond funds and reserve fund, the reserve fund being in effect a bond fund. It is also shown that some portion of the general fund was derived from assessments, water tolls, sales of property, and possibly some land rentals.

There had been a general default in the payment of assessments since 1926. The district took deeds to the property and cleared the titles. (R. 55.) The secretary of the district testified that the crash of the district was caused by the fact that one corporation owned over half the lands in the district and because of financial difficulties it was unable to keep up its assessments and the others soon defaulted. (R. 56.)

The amount provided to be paid each bondholder is $188.80 per thousand dollar bond, including interest from October 31, 1935, to the date of the first disbursement, December 27, 1937. (R. 80.)

II. THE CLAIMS WERE NOT PROPERLY CLASSIFIED.

Petitioners Moody, Jordan and Selby owned bonds in the amount of $19,000, which, with the accompanying interest coupons amount to approximately $30,000, and in addition interest at 7 per cent per annum as provided by Section 52 of the California Irrigation District Act upon $11,770 of matured bonds and interest coupons which were presented to the treasurer for payment and registered, from the date of such registration.

In this respect these claims differ from the claim of the R.F.C. in that the R.F.C.'s bonds were not presented to the treasurer and there is no 7 per cent interest on the matured bonds or coupons.

However, it is in respect of the presentation of the matured bonds and coupons amounting to $11,700 of the petitioners to the treasurer and their registration by the treasurer under the provisions of said Section 52 that the petitioners claim that they are entitled to separate classification.

Section 83(b) of the Bankruptcy Act provides in part:

> "* * * the judge shall classify the creditors according to the nature of their respective claims and interests: Provided, however: That the holders of all claims, regardless of the manner in which they are evidenced, and which are payable without preference out of funds derived from the same source or sources shall be of one class. The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as pro-

vided by law, shall accordingly constitute a separate class or classes of creditors."

Section 52 of the California Irrigation District Act as construed by the courts of California consistently, provides, we contend, such a preference.

Bates v. McHenry, 123 Cal. App. 81, is the leading case. The court said:

> "Again, the treasurer of the district has authority to perform two acts: He must either pay the bond or interest coupon when presented, or register the same. The irrigation laws do not confer upon the treasurer of the district any authority to pro rate payments. If the money is there and the bond or interest coupon is due, his legal duty is to pay. If money is not there, his legal duty is to register the bond and interest coupon and make payment, with the added interest, as soon as sufficient money is available."

In the case of *Shouse v. Quinley,* 3 Cal. (2d) 357, the Supreme Court of California held a section of the Irrigation Act unconstitutional and said:

> "By the general terms of the act, the bondholder had the right to have his bonds paid upon presentation if money were available and if not to have them registered and paid in the order of presentation."

In the case of *El Camino Irrigation District v. El Camino Land Corporation,* 12 Cal. (2d) 378, the Supreme Court of California said:

> "to permit successful judgment creditors, whose bonds may not be prior in registration, to be paid

by the proceeds of execution sales, would result in an unjustified preference. * * *"

and said further:

"* * * the procedure, unless restricted in some manner unknown to us, would operate to violate the rules of priority established by the decisions in this state. Bates v. McHenry, * * *"

In *Selby vs. Oakdale Irrigation District,* 140 Cal. App 171, the Court of Appeal reaffirmed this position, and in *Rohwer v. Gibson,* 126 Cal. App. 707, the court said:

"It is further provided in the California Irrigation District laws that unpaid registered interest coupons shall be paid in the order of their registration;"

We should point out that in the case of *Clough v. Baber,* 100 C. A. D. 946, 100 Pac. (2d) 519, the Third District Court of Appeal (not the highest court in California) sought to distinguish the facts of the particular case before the court, where the plaintiff sought payment of his $5000 of bonds out of $15,000 the district had. The court said:

"In the present case the district is insolvent; the lands have all been conveyed to the state on account of default of assessments; matured bonds in the aggregate sum of $283,000 are unpaid, many of which have been registered subsequent to petitioner's bonds; the rented lands fail to produce sufficient income to pay operating expenses and accruing interest to meet the debts of the district; the taxing power of the district

> has been entirely exhausted; there is no prospect of raising further funds in any manner whatever, with which to meet the present and future obligations of the district. Under such circumstances the petitioner is not entitled to payment in full of his five registered bonds as a preference, but the available funds should be apportioned pro rata among the holders of all valid claims."

Petitioners point out that where the highest court of the state has determined the law, the bankruptcy court should follow it. That court should determine from the statutes and decisions what the local law is. Here we have ample authority from the California Supreme Court.

The California rule is, we contend, propositions of law laid down in a decision of a District Court of Appeal, do not become expressions of opinion of the California Supreme Court, even where a transfer of the case to the Supreme Court is denied. (*People v. Davis,* 147 Cal. 346.)

If the decision in the *Clough v. Baber* case, supra, were the only decision, the bankruptcy court would be bound by it, though it is the decision of an intermediary court. But where there are decisions of the highest court of the state, those decisions should be looked to for interpretation of the local law. (*West v. American Tel. & Tel. Co.,* .....U.S....., 61 S. Ct. 179; *Fidelity Union Trust Co. v. Field,* .....U.S....., 61 S. Ct. 176; *Six Companies of California v. Joint Highway Dist.,* .....U.S....., 61 S. Ct. 186.)

In the following case decided in 1938 by the Supreme Court of California in a group of four cases in which the districts owned substantially all the land and there were practically no landowners left and the districts were heavily in default on their bond debt, the court discussed the economic situation as affecting bondholders' rights at considerable length and declared:

> "* * * "two things should be clear: first, that this money should go to the bondholders; and second, that in any event it should not be given to junior bondholders in preference to those with prior claims but should be paid on past due bonds and coupons in the order of their presentation."
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> *Provident Land Corporation v. Zumwalt,* 85 Pac. (2d) 116, 12 Cal. (2d) 365.

The court below said (114 Fed. (2d) 685):

> "But we decided in the Merced case that due bond interest and principal does not become preferred claims when presented and registered as provided by Section 52 of the California Irrigation District Act. Had the District proceeded in its course as a solvent entity, the holders of overdue bonds and interest would have been paid in accordance with Section 61 (a) of the California Irrigation District Act. But it did not and could not have so proceeded and it resorted to the Bankruptcy Law for relief."

In the Merced case, *West Coast Life Insurance Co. v. Merced Irrigation District,* 114 Fed. (2d) 654, the court had said:

> "We are convinced that appellants have erred in their reasoning that the registration gives a

> preference by law to the due but unpaid obligations that is different in any manner from the obligation of the bond contract as to due dates."

The court below seems to suggest in the Merced case that the Section 52 is simply for the purpose of arranging an orderly machinery for notification when funds become insufficient to meet the delinquencies and then gives another reason for that court's position that appellant's theory was erroneous, namely, "that the power of Congress in the field of bankruptcy * * * is both unlimited and supreme is not questioned". *Sturges v. Crowninshield,* 4 Wheat. 122, 192, 4 L. Ed. 529. Rights "* * * must be decided by the Bankruptcy Act, since it is superior to all state laws upon the subject." *Moore v. Bay,* 284 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133, 76 A. L. R. 1198; *New York v. Irving Trust Co.,* 288 U. S. 329, 53 S. Ct. 389, 77 L. Ed. 815. "We find nothing in the act justifying the classification suggested by appellants." (114 Fed. (2d) 654, at page 673.)

In *Ginsberg v. Lindel,* 107 Fed. (2d) 721, 725, 726, the court said:

> "Legislation by Congress may supersede that of a state in a particular instance, but Congress can not repeal a state law; nor can it exert control over individual property rights except in the proper exercise of its constitutional powers."

and said further:

> "There is, however, a significant difference between a property interest and a contract, Kuehner v. Irving Trust Co., supra, and the ex-

ercise of these powers does not permit the total or partial destruction of vested property rights. Due process of law 'inhibits the taking of one man's property and giving it to another, contrary to settled usages and modes of procedure, and without notice or an opportunity for a hearing.' Ochoa v. Hernandez, 230 U. S. 139, 141, 33 S. Ct. 1033, 1041, 57 L. Ed. 1427. Congress, in the exercise of the bankruptcy power, is bound by this principle and may not take a property right from one creditor and transfer it without compensation to another without violating the Fifth Amendment. Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 601, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106."

The petitioners contend that the court below has decided this important question of local law in a way in conflict with applicable local decisions and that the application of these local decisions on this question in the administration of the bankruptcy law under Chapter IX of the Bankruptcy Act is an important question of federal law which has not but should be settled by this court. Petitioners also contend that the Circuit Courts conflict in their opinions as just shown.

It is the contention of the petitioners not only that these claims have a preference provided by law but also that they are in effect secured by trust funds and properties.

La Forge v. McGee, 6 Cal. 650.

In *McKaig v. Moutrey,* 32 Cal. App. (2d) 537, 90 Pac. (2d) 108, the court said:

> "the assessment when so levied, became the property of the district and was held in trust for the bondholders under Section 29 of the Irrigation District Act."

People v. Bond, 10 Cal. 563-573, where the court held that moneys collected by the treasurer "stands as a trust fund which the treasurer, as the bailee of this sum, is to pay the commissioners". See also

Ecker v. S. W. Tampa Storm Sewer Drainage Dist. 75 Fed. (2d) 870, 872;

Hidalgo County Road Dist. v. Morey, 74 Fed. (2d) 101;

River Farms Co. of Calif. v. Gibson, 4 Cal. App. (2d) 731.

In the case of *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 Pac. (2d) 116 at 120, the court said:

> "the lands remain in trust, and the district exercises its powers, however broad, as a trustee. Once it is made clear that the lands are held in trust, it necessarily follows that their proceeds, whether by sale or lease, are likewise subject to the trust."

We respectfully submit that $11,770 of the claims of the petitioners, with 7 per cent interest from the respective dates of presentation to the treasurer, are entitled to classification as a separate class and the plan should only have been confirmed upon condition that such classification be recognized and that these obligations be paid in full out of the trust funds consisting of bond fund moneys, $12,597.30, the $30,000

deposited with the R.F.C., as a guarantee against liability for this payment, and out of other trust fund properties, including rentals. If the plan be otherwise confirmed then this condition of confirmation should be decreed, and the balance of petitioners' claim would be paid pro rata in the same manner as other claims against the district.

III. THE DISTRICT IS A TRUSTEE FOR THE BONDHOLDERS.

We have already shown under the foregoing head that all the property of the district is held in trust for the uses and purposes of the act. This position was thoroughly expounded in the case of *Provident Land Corporation v. Zumwalt,* supra, where it is held that the directors of the district might take out sufficient funds to pay the operating expenses of the district and after having done so the remainder of the fund which should be accumulated as a surplus, should be paid to the bondholders in the order of presentation of their claims.

In this particular case the district has taken title to the land in the district. It has proceeded to compromise with the county the tax delinquencies against the land. Funds made available by the R.F.C. and paid to the district by the bondholders who turned in their bonds to the R.F.C. enabled the district to liquidate the indebtedness of the Reclamation District. It therefore holds this land in trust, free and clear of all encumbrance, and the Supreme Court of California has lately held in an important decision that an

irrigation district holding title to land under these circumstances holds it free and clear of the power of taxation of the county or other public agencies. (*Anderson-Cottonwood Irr. Dist. v. Klukkert,* 13 Cal. (2d) 191.)

Therefore, the sole beneficiary of that trust, after taking out operation costs, is the payment of the indebtedness of this district. Why, then, should this trustee go to the R.F.C., borrow money from that corporation, and attempt to liquidate its obligations under this trust by the payment only of the amount it can borrow from the R.F.C.? And what social necessity, or what national or state program requires that this land, which is owned by this public agency in trust to pay these bonds should be taken from these bondholders? Inasmuch as this district would not have to pay taxes upon this land as long as it holds the land, would not the bondholders be in a much better position if the district retained the title to the land, leased it out to farmers, free and clear of the liability to pay any taxes whatever, and devoted the proceeds of those rentals toward the liquidation of the indebtedness of the district so far as it would go? In this manner the bondholders would be in a position to benefit from the possibility of future increment over and above the amount of the present borrowing from the R.F.C., and would of course benefit by the increased revenue which would come by way of rentals. The district is able to collect for its treasury the *full rental value* of the land without any obligation to surrender any portion thereof to a county or any other taxing authority in taxes.

The rental value of the land pledged as security is equivalent to a first lien on all of the property of the district. To permit any portion of this rental value to accrue to private interests as it would if this plan is confirmed or to the State of California, is tantamount to allowing a second mortgage to be paid while the first mortgage is ordered drastically scaled down. These bonds of course are general obligation bonds, payable by unlimited taxes, according to land values, not according to "ability to pay".

Roberts v. Richland Irr. Dist., 289 U. S. 71;
Rialto v. Stowell Irr. Dist., 246 Fed. 294;
Farwell v. San Jacinto Irr. Dist., 49 Cal. App. 179;
Provident Land Corp. v. Zumwalt, 12 Cal. (2d) 365.

In *Judith Basin Irrigation Dist. v. Malott*, 73 Fed. (2d) 142, the court says:

> "It has been uniformly held that bonds of an irrigation district issued in pursuance to the Wright Act * * * are general obligations of the district."

and further:

> "The payment of the bonds at earliest maturity does not release any parcel of the land from the lien of the bond, and all the land within the district, according to the terms of the bond and of the statute are liable for the payment of the unpaid bonds."

Should the bankruptcy court apply the "ability to pay" yardstick, when the state has adopted a different yardstick in its taxation system?

The court below seems to have ruled that when the rental value or usufruct of land is pledged to the State, as here, and that security is pledged by the State, through its Governmental Instrumentality, for money borrowed to finance the cost of State owned permanent public improvements, the State can "consent" to repudiate its contract, for the benefit of non-creditors.

Is landlordism subject to the Bankruptcy clause, only when as here it is the State that is the landlord?

In more than one other California Irrigation District, full and complete title to all the land is and has been vested in the District for years. That fact however has not caused any district to "collapse" any more than had private mortgagees foreclosed the same land.

The concern expressed in the Ashton minority opinion, to the effect that failure to approve a petition would result in all parties being "caught in a vise" is wholly inapplicable under California law.

The district title to tax reverted land is free and clear of all mortgages or other private liens formerly on the land, including any mortgages securing Federal Land Bank bonds.

If the land in the district should prove to be without a rental value, those who invested in the bonds would obviously never get paid. But no scale down of the bonds will improve or increase the rental value of the land. Whether this rental value, present or

future is much or little, it is pledged as a public trust and made by law the exclusive property of the irrigation district, dedicated to any degree or extent necessary to meet the district's costs of operation and lawful debts when, as and if funds are available.

Are the rights of the state to the rental value of land pledged for security for money borrowed by its agency any more subject to control by a court of bankruptcy than rent promised to a private landlord? Our courts uphold the doctrine that it is illegal for a bankruptcy court to require a private landlord to continue a lease in effect for rent less than that stipulated in the contract. By confirming the plan here, the court in effect made it legal to compel the holders of these bonds to surrender a part of their right to the rental value of these lands, and this for the benefit of the state, in spite of the fact that our courts have held that it is the duty of the county to keep lands on the paying tax roll, even to the extent of discharging other public obligations.

County of San Diego v. Hammond, 6 Cal. (2d) 709;

County of L. A. v. Jones, 6 Cal. (2d) 695.

It matters not whether the rental value of land in a California Irrigation District be much or little. Whatever it is or may become, it is the exclusive property of the district, and is in effect dedicated to the public trust to any degree or extent necessary to meet the costs of operation and the debts of the district. (*Provident Land Corp. v. Zumwalt,* supra.) If the land has no rental value the bonds will never be paid,

and no bondholder would be allowed to sue the state. No user of land could be compelled to pay more than the actual economic rent, that is, no more than he would have to pay a private landlord. Whether this rent is paid to a private landlord or to a state agency matters not to the user of lands. It is only as private interests are enabled to appropriate the ground rent which they believe they can charge users of land that land acquires a so-called market value. The only effect of denying the petition of the district for relief will be to keep the land prices from rising as high as they otherwise would, for the district could rent the land on a cheaper basis than it can sell it.

IV. THE PLAN IS NOT FAIR NOR EQUITABLE.

The plan is not fair for the following reasons:

1. It does not classify the petitioners' preferred claims separately.

2. It does not give to the bondholders the full benefit of the value of the assets of the district. In the first place it merely gives them what it can borrow from a banker, and that, as we have shown, is not in excess of 60 per cent of the value of land and works of the district. Second we have shown in the last preceding subject head that the district is seeking to take from these bondholders a possible future benefit or future value.

Finally, we contend that the plan is not fair because it has been in effect executed and carried out and the consenting bondholders have surrendered and cancelled

their claims against the district in favor of the district. When these bonds were surrendered the case became moot.

V. CHAPTER IX OF THE BANKRUPTCY ACT CAN NOT EXTEND TO THIS DISTRICT NOR CAN THE STATE CONSENT TO SUBJECTING THIS DISTRICT TO THE BANKRUPTCY PLAN.

We contend that since the Supreme Court of California has held that all of the functions of the California irrigation districts are governmental, that the Bankruptcy Act cannot extend to a California irrigation district. These decisions having come down from the California Supreme Court, and the law having become definite after the decision in *U. S. v. Bekins,* 304 U. S. 27, 82 L. ed. 1137, this Court should reexamine this issue in order to determine whether or not the Bankruptcy Act can apply at all to such a district under our constitution.

Risty v. Chicago R. I. & P. R. Co., 270 U. S. 378;

Chicago M. St. P. & P. R. Co. v. Risty, 276 U. S. 567.

It is also our contention that the James Irrigation District stands in a different position than the public agencies in some of the other cases whose composition plans have come before the court. Here, the district has acquired title to all of the land except a mere fraction. These bonds were issued by the State of California and bear its seal and are made payable by a state agency out of the resources and power of assessment delegated to that state agency. They are

therefore in legal effect obligations of the State of California, limited as to the source of payment. The state could legally pay these bonds, or it could permit the county to pay them.

County of L. A. v. Jones, supra;
County of San Diego v. Hammond, supra.

They are state obligations.

In another sense they are the obligations of the landowners, within the district, for such a bond is in effect a contract between the landowner and the bondholder.

Hershey v. Cole, 130 Cal. App. 683.

The state acquires the property from the landowners by tax process, in the name of the district (*Anderson-Cottonwood v. Klukkert,* supra) for the amount of the delinquent assessment. A private purchaser could not buy this property at tax sale for less than the amount of the assessment. (Secs. 44, 47, *California Irrigation District Act.*) It would seem, therefore, that the state cannot rid itself of liability on the bonds otherwise than by the process of law by sale of the land to private owners, and of course it is established that such sale is made subject to the debt of the district. (*Provident v. Zumwalt,* supra.) Therefore, we contend that the state's consent to the bankruptcy proceeding amounts to repudiation of the state's own indebtedness, and that it cannot do this; that the bankruptcy power does not extend to the state in such a manner as to enable the state to repudiate its own debts. Here the state has become the owner of the land. It is also maker of the bonds. In a peculiar and

double sense, therefore, it is the debtor and it cannot, we maintain, repudiate its own debt. (Minority opinion in *Ashton v. Cameron County Water Improvement Dist. No. 1,* 298 U. S. 513.) Were there landowners in this district other than the state there might be a logical basis for the position that the state can consent to a bankruptcy proceeding which involves a contract between those landowners and the bondholders. But where the state has succeeded to the interest of the landowners, and becomes the landowner as well as the debtor, it does not seem that bankruptcy can intervene to cancel and repudiate the indebtedness.

In the third place, California Constitution, Art. XIII, Sec. 6, provides:

> "The power of taxation shall never be surrendered or suspended by any grant or contract to which the state shall be a party."

We contend that the state's consent violates this provision of the State Constitution.

In *Board of Commissioners of Wood County v. State* (Okla. 1926), 257 Pac. 778, 779, it was held that a statute providing that the lien of the state under a mortgage should be prior to the lien for taxes violated Section 5 of Article X of the State Constitution, which provided:

> "The power of taxation shall never be surrendered, suspended, or contracted away."

In *Nelson v. Pitts* (Okla. 1926), 259 Pac. 533, the same constitutional provision was applied, the Supreme Court declaring invalid a statute which pro-

vided that upon the sale of property the proceeds should be applied first to the payment of the special assessment liens.

The power of taxation is not limited by ability to pay.

> "In estimating the value of land, an assessor should take into consideration all of its elements or incidents, such as location, quality, condition, improvements, and use, which affect market value or would influence the mind of a purchaser. Also, the adaptability or availability of the land for a particular use may be considered in so far as it enhances the present actual value of the land. * * *." 61 C. J., pp. 643, 644, § 793.
>
> "Except in some jurisdictions, the rental or net income producing-capacity of real property which is rented or produces income is an important element to be considered in determining the actual or market value of the property for purposes of assessment, but it is not the only element to be considered, and in many instances the amount of rental received would be wholly misleading." Ibid., pp. 644, 645, § 794.

Here the court bases its finding of fairness solely upon the "ability to pay" theory. That the bonds were issued on an entirely different basis of security and taxation in these districts is not based upon "ability to pay". How can the bankruptcy court take a different standard than that provided by state law? May property which has value but no income escape taxation?

We also contend that Article I, Section 14 of the California Constitution which provides that the legislature has no power to take property of one person and give it to another nor to take it for a public use without compensation, prohibits the taking of these bonds and consenting to the bankruptcy procedure.

California also has a constitutional provision prohibiting the impairment of the obligation of contracts. Article I, Section 16. It seems to us that there is a fallacy in the line of thought suggested that because Congress has power under the bankruptcy clause to enact bankruptcy legislation and the state's consent does not violate the national constitutional provision against the impairment of the obligation, that the same holds true with respect to the state's constitution. The people of California had the right to write into their constitution a provision that in spite of the national bankruptcy act, the state cannot impair the obligation of a contract. Also it is fallacious, it seems to us, to say that this impairment is by the court, not by the state itself. To this our answer is that the California Constitution also prohibits the delegation of powers to a court other than those set up by the State constitution. Article VI, Section 1.

True, in the case of *Peoples State Bank v. Imperial Irrigation District,* 99 Cal. Dec. 317, 101 Pac. (2d) 466, the court holds the state can consent. This decision goes no further than to declare that in *U. S. v. Bekins,* 304 U.S. 27, it was held that the state could consent. In other words, it decides a question of federal law, not a question of state law.

Finally, having in mind the separability clause which is added to the amended Chapter IX, the Congress must have added that clause with a definite purpose in mind. We submit that if there is any sort of instrumentality or political subdivision of the state which is entitled to immunity, it must be the James Irrigation District. Its functions are exclusively governmental. The power to borrow money and to tax are essential powers of sovereignty. Any infringement of those powers must be in interference with sovereignty.

No sovereignty can give up a sovereign right and remain sovereign. It is to that extent less sovereign. If the provisions of Chapter IX apply to an instrumentality of the state, such as this district, it must involve the enlargement and extension of federal powers over the state. This the state is powerless to authorize.

Carter v. Carter Coal Co., 298 U.S. 238.

Given control of the states' borrowing and taxing powers, Congress will possess a power that might easily lead to their destruction. This court has not yet held that Congress has power to tax the bonds issued by these state instrumentalities nor their income. We affirm that such taxation does not extend to them even with the consent of the state, and we contend by way of analogy that to extend bankruptcy to the state and these bonds is to destroy the bonds Congress cannot tax.

CONCLUSION.

It is submitted that a writ of certiorari should be granted, the decree of the court below reversed and the proceeding directed to be dismissed.

Dated, Turlock, California,
January 6, 1941.

Respectfully submitted,
W. COBURN COOK,
Counsel for Petitioners.

Due service and receipt of a copy of the within is hereby admitted

this_____day of January, 1941.

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Counsel for Respondent.